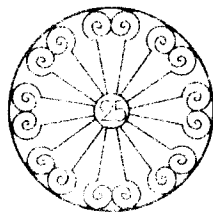


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# YCR LAW

Young Clement Rivers, LLP

Michael A. Molony

Direct Dial: (843) 724-6631

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March 7, 2012

**Via Electronic Filing**

Jocelyn Boyd  
South Carolina Public Service Commission  
P.O. Drawer 11649  
Columbia, SC 29211

Re: Kiawah Property Owners Group, Inc  
PSC Docket No. 2011-317-W/S  
YCR File: 2589-20110772

Dear Jocelyn:

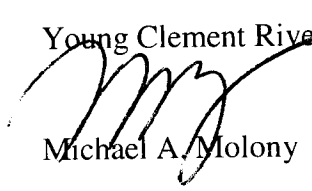
Enclosed please find Kiawah Island Property Owner's Group Inc. Petition for Rehearing in the above referenced matter.

I am providing a Certificate of Service, indicating all parties of record have been provided this Petition for Rehearing.

With kind regards, I am

Sincerely,

Young Clement Rivers, LLP

  
Michael A. Molony

RECEIVED  
2012 MAR -7 PM 1:55  
SC PUBLIC SERVICE  
COMMISSION

MAM/jrh

Enclosure(s)

cc: David Butler  
Shannon Bowyer Hudson  
Jeffrey M. Nelson, Esquire  
G. Trenholm Walker, Esquire  
John P. Seibels, Jr., Esquire  
Jason S. Luck, Esquire  
Diane Lehder  
Wendy Kulick

RETURN DATE: HL  
SERVICE: OK

BEFORE THE  
PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

Docket No. 2011-317-W/S

CERTIFICATE OF SERVICE

We hereby certify that on this 7th day of March, 2012, we served a copy of the foregoing

Petition for Rehearing of Intervenor Kiawah Property Owners Group, Inc. upon:

G. Trenholm Walker, Esquire  
Pratt-Thomas, Pearce, Epting, & Walker  
P.O. Drawer 22247  
Charleston, South Carolina 29413-2227

Shannon Bowyer Hudson, Esquire  
Counsel, Office of Regulatory Staff  
1401 Main Street, Suite 900  
Columbia, SC 29201


Jeffrey M. Nelson, Esquire  
Counsel, Office of Regulatory Staff  
1401 Main Street, Suite 900  
Columbia, SC 29201

Jason Scott Luck, Esquire  
John P. Seibels, Jr. Esquire  
Kiawah Island Community Association,  
Incorporated  
The Seibels Law Firm  
127 King Street, Suite 100  
Charleston, SC 29401

Jocelyn Boyd  
Chief Clerk & Administrator  
South Carolina Public Service Commission  
P. O. Box 11649  
Columbia, SC 29211

by electronic filing.

DATED at Charleston, South Carolina, this 7<sup>th</sup> day of March, 2012.



MICHAEL A. MOLONY, ESQUIRE  
Young Clement Rivers, LLP  
25 Calhoun Street, P.O. Box 993  
Charleston, South Carolina 29401

Charleston, South Carolina

2012 MAR -7 PM 1:53  
PUBLIC SERVICE  
COMMISSION

2012 MAR -7 PM 1:53

RECEIVED

**BEFORE**  
**THE PUBLIC SERVICE COMMISSION OF**  
**SOUTH CAROLINA**  
**DOCKET NO. 2011-317-W/S**  
**March 7, 2012**

**IN RE: APPLICATION OF KIAWAH ISLAND  
UTILITY, INC. FOR APPROVAL OF  
AN INCREASE IN ITS RATES FOR  
WATER AND SEWER SERVICES**

**PETITION FOR REHEARING  
OR RECONSIDERATION**

Pursuant to S.C. Code Ann. § 58-5-330 and S.C. Code Reg. § 103-854, Kiawah Property Owner's Group ("**KPOG**" or the "**Intervenor**") petitions the Public Service Commission ("the **Commission**") for rehearing and/or reconsideration of the matters set forth in its order of February 8, 2012 on the grounds specified in this application. The Order was received by KPOG on February 16, 2012 by certified Mail.

**INTRODUCTION**

This matter is before the Commission by way of an Application for Adjustment of Rates (as amended and supplemented, the "**Application**") filed on August 3, 2011 on behalf of Kiawah Island Utility ("**KIU**") pursuant to S.C. Code Ann. § 58-5-240 and 23 S.C. Code Ann. Reg. §§ 103-512.4.A and 103-712.4.A.

On February 8, 2012, the Commission issued an order adopting the proposed order of Office of Regulatory Staff ("**ORS**") with two modifications. KIU was instructed to remove all expenses relating to the Cougar Island purchase and to adjust the federal income tax rate to 34%.

## **PROCEDURAL BACKGROUND**

By letter dated August 15, 2011, the Commission instructed KIU to publish a prepared Notice of Filing, one time, in a newspaper of general circulation in the area affected by the Application. The Notice of Filing indicated the nature of the Application and advised all interested parties desiring to participate in the scheduled proceeding of the manner and time in which to file the appropriate pleadings. In the same letter, the Commission also required KIU to notify directly all customers affected by the Application by sending each such customer a copy of the Notice of Filing by U.S. Mail.

In response to the Notice of Filing, KPOG and the Kiawah Island Community Association (“KICA,” and together with KPOG) filed Petitions to Intervene. Pursuant to S.C. Code Ann. § 58-4-10 (B), ORS is a party of record.

On October 20, 2011, the Commission held a public hearing in the Town of Kiawah Island (the “Town”) to obtain information from the KIU’s customers as to the service being rendered and to identify any issues of concern related to the Application.

After reviewing the Application, ORS made on-site investigations of KIU’s facilities, reviewed KIU’s books and records, and gathered other information concerning KIU’s business operations. The intervening parties likewise conducted their discovery with regard to the Application.

KIU prefiled direct expert testimony for John F. Guastella (President) and Gary C. White (Vice President and Director of Accounting) of Guastella Associates, LLC, a utility rate consulting company, as well as J. Mitchell Bohannon, III of Thomas & Hutton Engineering Co. KIU also prefiled direct testimony for Becky Dennis (General Manager) and Steven D. Heyboer (Chief Financial Officer). KIU prefiled rebuttal testimony for Guastella, Dennis, and Heyboer.

ORS prefiled the direct testimonies of its witnesses: Daniel F. Sullivan (Auditor) and Hannah K. Majewski (Program Specialist for the Water and Wastewater Department).

KPOG prefiled direct testimony for Diane Z. Lehder (its President) and Wendy K. Kulick (a Director and former President), both of whom are long-time residents of the Town. KPOG also prefiled expert testimony of Ellen Blumenthal and Lynn M. Lanier, principals of GDS Associates, Inc., a utility consulting and engineering firm, and William D. Rogers, Vice President and Treasurer of American Water Works, the country's largest investor-owned water utility company.

A public hearing regarding matters asserted in the Application was held on November 30, 2011 in the Hearing Room of the Commission, with Chairman Howard presiding. G. Trenholm Walker, Esquire, represented the KIU. Michael A. Molony, Esquire, represented KPOG, and Jason S. Luck, Esquire, represented KICA. ORS was represented by its counsel, Shannon B. Hudson and Jeffrey M. Nelson.

At the hearing, KIU presented the testimony of Guastella, White, Dennis, Heyboer, and Bohannon. KPOG presented the testimony of Lehder, Kulick, Blumenthal, and Lanier. ORS presented the testimony of Sullivan and Majewski. KICA presented no witnesses. All parties agreed to stipulate to the testimony of Mr. Bohannon, Ms. Kulick, Ms. Lehder, and Mr. Rogers. Mr. Rogers testimony was stipulated with the caveat that an affidavit attesting to the accuracy of his testimony would be filed as late filed exhibit with the Commission. The Affidavit was submitted to the Commission for inclusion in the November 30, 2011 Hearing Transcript on January 11, 2012.

The Commission issued an interim order on February 1, 2012, which adopted the proposed order of the ORS with two modifications: KIU was instructed to remove all expenses relating to

the Cougar Island purchase and to adjust the federal income tax rate to 34%. In conformity with the Commission's instruction, and with the assistance of the ORS, new financial data and revised rates were filed with the Commission and served on all parties by February 6, 2012, to reflect these changes (KIU's Statement of Compliance with PSC Interim Order). KPOG and KICA reserved their objections pending receipt of the Commission's final Order.

### **GROUND FOR REHEARING**

KPOG respectfully requests the Commission reconsider several extremely important and relevant issues raised with respect to KIU's rate application and of certain KIU operating and financial practices which clearly violate Commission Regulations.

1. The Commission's Order denied any expense associated with the purchase of the Cougar Island Tract for the purpose of ratemaking. The Commission, however, failed to address KIU's non-compliance with its own rules regarding preapproval of contracts with respect to the land and related financing transactions in 2008 and 2009. The fact that these occurred outside of the test year should not exclude them from the Commission's Order because expenses related to these transactions do appear in the test year.
2. The Commission failed to address the audited financial statements of KIU, which were introduced as evidence, without objection, even though they contain a number of financial issues affecting the rates established by the Commission and the viability of the long-term stability of KIU.
3. The Commission failed to establish a reasonable and appropriate Operating Margin and rate increase given the current economic environment. In doing so, the Commission gave absolutely no consideration to the testimony of expert witness William Rogers. This

despite the fact that neither KIU nor ORS offered any meaningful challenge to his testimony at any point during the Application and hearing process.

4. The Commission's Order made no Finding of Fact or Conclusion of Law which addressed the public input in this proceeding. None of the comments from either the public hearing on Kiawah or letters written to the Commission were addressed in the Commission's Order. Numerous significant issues were raised by 13 public witnesses during the October 20, 2011 Night Hearing and letters from more than 100 rate payers were submitted to the Commission in opposition to the rate increase.
5. KPOG respectfully disagrees with the Commission's February 1, 2012 Directive denying KPOG'S request to overrule the Hearing Officer's Denial of its Motion to Compel and KPOG's request to take judicial notice of certain Charleston County property tax records.

### **DISCUSSION**

1. **The Commission's Order denied any expense associated with the purchase of the Cougar Island Tract for the purpose of ratemaking. The Commission, however, failed to address KIU's non-compliance with its own rules regarding preapproval of contracts with respect to the land transactions in 2008 and 2009. The fact that these occurred outside of the test year should not exclude them from the Commission's Order because expenses related to them do appear in the test year. (Commission Regulation 103-541 and 103-743)**

While the Commission properly disallowed expenses associated with the 2010 purchase of the Cougar Island Tract, the Commission failed to exclude expenses associated with the 2008

and 2009 property purchases which were embedded in the test year expenses, including interest expense, property taxes, and O&M expenses.

The Commission erroneously characterizes KPOG's position in this proceeding when it posits that KPOG's arguments focus solely on attacking the relationship between KIU and KRA (Order No 2012-98 P. 10).

Specifically, the focus of KPOG's objections relate to KIU's onerous contractual agreements and loan provisions with RBC, none of which were preapproved by this Commission as required by PSC Regulations 103-541 and 103-743. While the Commission has historically taken the position that it has no jurisdiction over KIU's parent, it is clear that the Commission has not only the authority but the responsibility to review and preapprove significant transactions KIU would be entering into with any entity, whether its parent or a third-party. Therefore, this oversight by the Commission should have been exercised before KIU entered into its mortgage, security and loan agreements with RBC. The Commission accepted KIU's contention that the "Down Island Storage Facility Tract" in 2008 (the "**2008**" transaction) and the "General Warranty Sora Rail Tract" 2009 (the "**2009**" transaction) land transactions were purportedly approved as part of a purchase option contained in the lease agreements. This is incorrect for several reasons.

First, KIU failed to meet its burden of proof as to terms and conditions of these leases, any amendments to the leases and the preapproval of the leases by the Commission. This is particularly important in light of the admonition by the South Carolina Supreme Court in Hilton Head Plantation Utilities, Inc. v. Public Serv. Comm'n of S.C., 312 S.C. 448, 451, 441 S.E.2d 321, 323 (1994) that intercompany transactions and expenses must be closely scrutinized by the Commission.



While the Commission may have discussed the leases in previous rate applications, a purchase option for the purported sale of property does not automatically confer Commission approval of purchase price nor numerous complex contractual agreements and financing documents in violation of Commission Regulations 103-503 (B) and 103-703(B).

Second, KIU argues the Commission has approved, implicitly or directly, the transactions it entered into in 2008 and 2009, via leases that were referenced in earlier rate cases. There is no provision in the Commission's rules and regulations regarding implicit approval.

Further, KIU did not introduce any competent documentary evidence nor cite any prior Commission Orders to demonstrate it had received direct Commission preapproval of these leases. In fact, KIU witnesses neither - of whom negotiated the leases - were familiar with their terms (Tr. Vol. II P.181 lines 14-19). Page 11 of the Evidence and Conclusion for Finding of Fact No. 4 of the Order, recites Heyboer's testimony that there were purchase clauses in the lease agreements; however this statement is completely unsupported by any documentary evidence in the record thus failing to meet KIU's burden of proof (Tr.Vol. II P. 173). More importantly, KIU witness Heyboer testified that the amendments to the leases, not the leases themselves, allowed for the sale of the assets (Tr. Vol. II P. 183 lines 3-10). Heyboer's testimony confirms KIU's lack of evidence in the record of **any** approval of these leases, amendments to the leases or alleged options to purchase the properties in question. KPOG would restfully request the Commission take notice of Order No.: 97-4.

Third, even if the leases had been approved, the leases do not provide for engaging in the complex transactions KIU consummated with RBC Bank; rather, the leases deal solely with the purchase price mechanism between the parent and KIU. Simply put, signing a deed does not give KIU the authority to enter into complex contractual agreements and one-sided loan documents

with onerous mortgage provisions, security interest terms and short-term financing of virtually all of KIU's debt, this on top of encumbering KIU for almost its total assets.

In fact, the deed is simply a transfer in the mode of ownership. KIU and all of its assets continue to be 100% owned by KRA through all of its stock ownership of KIU. The form of ownership is all that has changed (increased equity for a deed transfer.) Page 12 of the Evidence and Conclusion for Finding of Fact No. 4 of the Order, the Commission notes the consideration stated in the deed between KIU and the parent, but does not take into account the oppressive and onerous contractual terms between KIU and RBC. The Commission bases its approval of not only the transfer of land between KIU and its parent, but also the contract and the terms of the loan agreement on the land transfers, none of which are included in the record of the proceeding in this case. In this case, the leases (or amendments thereto), and deeds are merely the platform used by KIU to engage in numerous unapproved contractual provisions with its lender, RBC.

Set forth below are just a few examples of the complex and "non-public" purpose, in the unapproved contracts, and loan agreements, all of which are directly in violation of the Commission Regulations 103-541 and 103-743.

### **MORTGAGES**

The loan documents grant mortgages on the properties with the following provisions, which directly and adversely affect KIU and its ratepayers now, as well as in the event of a default:

- \$15 million future advance clauses in both mortgages (Pgs. 2 and 16 of Stipulated Exhibit 14).
  - These provisions give KIU, among other things, the unequivocal right to borrow, without Commission approval, an additional amount of up to \$15

million without any oversight by or approval of the Commission as to the use of those proceeds. There is nothing in the Commission's Order that limits the ability of KIU to take advantage of even this one provision. In fact, KIU will most likely take the position that the loan transaction documents themselves have been approved, just as it has taken that the land leases approve the sale of the properties from KRA to KIU.

- Entry into an undefined credit facility with no identity of the participants, purposes or terms of that facility (P. 23 of Stipulated Exhibit 14 and P. 3 of Stipulated Exhibit 16).
  - This provision places the debt of KIU in a facility that is undefined, unapproved and ostensibly interconnected with the debt of other related entities. (P. 21 of Stipulated Exhibit 14). The broad language of the loan documents reflect that a default on any debt on that facility would result in a default on all debt.

### **SECURITY INTEREST**

The loan documents grant security interests in all of the assets of KIU, which, upon default, dramatically affects KIU's ability to provide utility services. The following are examples:

- RBC can take possession of and control KIU without Commission approval; (S.C. Code §§36-9-101, et seq.); (P. 8 of Stipulated Exhibit 14, and P. 4 of Stipulated Exhibit 16).
- RBC can require KIU to notify all customers to make payments directly to the RBC (§36-9-607(a)); KIU is a "transmitting utility", which §36-9-102 (a)(80) defines to include any

entity primarily engaged in the business of: ....(D) transmitting or producing and transmitting electricity, steam, gas, or water, purportedly giving RBC unconditional rights to operate KIU without Commission approval. (Chapter 9 of the South Carolina Uniform Commercial Code)

- A pledge of all of KIU's stock and ownership rights to RBC. (Stipulated Exhibits 17, 18, 19 item 8), even the very Certificate of Authority issued by the Commission.

Further, KIU has claimed the transactions in 2008 and 2009 were outside the test year and thus irrelevant. As stated earlier, it is important to acknowledge the impact of the financing costs of those transactions, which **are** embedded in the new rates that have been implemented. ORS presented testimony that it had examined the loan documents and specific loan transactions, but presented no testimony that it had reviewed the specific leases, appraisals, or amendments. Yet, despite KIU's failure to meet its burden of proof, these prices were deemed to be fair and reasonable (Tr. Vol. II P 452 lines 4-10).

More importantly, when the purchase of the properties was challenged as to the public purpose, no testimony was presented that such was the case. In fact, as KPOG noted during the November 30, 2011 hearing, the opposite is true. These financing transactions with RBC and the sale from KRA to KIU were not even remotely time sensitive. While "Fair Market Value" is addressed in the Commission's Order, what is missing is acknowledgement of the economic climate at the time of the purchases (2008-2010 during an economic downturn) and its impact on the value of those properties at that time. In addition, no evidence was presented that the appraisals of the properties were completed for land intended for Utility facilities or already developed as such, as opposed to property suitable and usable for residential development. Disallowing the expenses associated with all of the RBC loans would not prejudice KIU, since it

received a rate adjustment at the end of 2010 and will likely file for the approval of the second water line in 2012.

KIU has filed seven different applications since 2002, even as late as 2010, for pass through rate adjustments. A simple request in any of those proceedings could have apprised the Commission and the ratepayers of these land purchases and loan transactions thus placing KIU in a position to be in compliance with the regulations upon Commission approval.

In sum, while there may be three deeds involved (2008, 2009, and 2010), there is but one major financing transaction, more importantly, a transaction which was not approved by this Commission.

### **UTILITY SERVICE AGREEMENT**

In its 1996 Order, the Commission admonished KIU for its failure to submit the 1994 Utility Service Agreement (“USA”) with its parent for preapproval. This overt act by KIU was a flagrant transgression which cannot be ignored. The 1994 Agreement stipulated in part that any transfer of property from the parent to the Utility would be at no more than 50% of Fair Market Value (“FMV”).

In 1997, KIU’s parent company terminated the 1994 USA and entered into a new USA with the Utility. The new Agreement radically altered its terms. Specifically, it stipulated that any transfer of property from the parent to the Utility would now be at FMV, doubling the cost to the Utility and its rate payers. There was no quid pro quo provided for this concession by the Utility and, therefore, no public benefit provided.

Despite the Commission's admonishment of KIU in 1996, the Utility made a conscious decision not to submit this revised Agreement for preapproval by the Commission. In fact, neither KPOG nor the Commission became aware of this revised Agreement until it was disclosed in response to the first set of interrogatories promulgated by KPOG to the Utility.

KPOG does not believe the Commission intended to imply its acceptance of the 1997 USA between KIU and its parent, which doubled the cost of any property purchase, as being in the public interest. However, KIU provided no evidence demonstrating the public benefit and this was not addressed in the Order, it is important the Commission make a clear statement about this issue. At a minimum, the Commission should reduce the fair market value of the land by 50% and deduct that amount from the rate application.

Witness Heyboer stated he had not reviewed the 1994 Utility Service Agreement, but had reviewed the 1997 Utility Service Agreement (Tr. Vol. II P. 193 lines 4-9). Even he, as an advocate for the Utility, could not say what public benefit was obtained from the 1997 Utility Service Agreement. The Commission improperly rejected KPOG's argument that these items should be excluded altogether from KIU's operating expenses. The 1997 Agreement was never submitted to the Commission for preapproval in violation of the Commission's rules.

**2. The audited financial statements of KIU, which were not reviewed in detail by the ORS staff, contain a number of important financial issues directly related to the proposed increase which were not addressed in the Order.**

On page 13 of the Evidence and Conclusion for Finding of Fact No. 4 of the Order, the Commission references establishing an appropriate income requirement and operating margin on the application and business records of that entity. The most important and accurate business

records introduced during the proceeding were KIU's audited financial statements from 2001-2010, the period covered between the last rate application and the present one. As stated earlier, these audited financial statements were not reviewed by ORS in detail, nor could they be, since they were only produced by KIU to KPOG on November 4, 2011 (Tr. Vol. II P. 456, lines 20-25 and P. 457 lines 1-7). Prior to KIU producing them, ORS did not seem to place any importance on the distinction between audited financial statements and the day-to-day accounting records the Utility provided.

It is unusual and interesting to note that KIU has changed its auditors over the years (see Stipulated Exhibits 1-8 auditing firm 2001-2008 and Stipulated Exhibits 9-10 2009-2010 a new auditing firm). Moreover, it is disconcerting that KIU restated its 2008 and 2009 audited financial statements which are included in its 2010 audit report (P. 15 Note 14 2010 Audited Financial Statements).

As a further example of accounting practices that relate to this proceeding, the audited financials disclose related party transactions between KIU and its parent which were never approved by the Commission. Specifically, a land exchange which occurred in 2010 in the amount of \$1,264,450 for an equal addition for a note payable (P. 6 Non Cash investing and financing activities 2010 Audited Financial Statements). KIU argues it must seek "external financing" for KIU's operations yet at least in this one particular instance it has elected to exchange a note, as reviewed and reported by its auditors.

Additionally, there was testimony and cross-examination of KIU witness Heyboer on KIU's utilization of an interest rate swap in connection with its most recent financing transaction. As the Commission is aware, an interest rate swap is a complex derivative instrument that is governed by unique new accounting rules adopted after the financial crisis of 2008. KPOG

respectfully submits it is unusual for a company that is characterized by one of its own expert witnesses as a "small utility" to enter into a complex derivative "interest rate swap" on its debt.

The interest rate swap accounting lists a \$254,499 liability on KIU's books as of 12/31/2010. Again, this is also a part of the 2008 and 2009 transactions, which were not preapproved by the Commission, that entangle KIU in this derivative without any explanation of the terms of the derivative, who the counterparty of the derivative is (which could make the derivative worthless if it is a weak counterparty), and the pricing terms for this derivative. KIU also carries over \$900,000 in deferred tax liability on its books. By not disallowing these transactions and expenses, the Commission is, perhaps inadvertently, rewarding KIU for violation of Commission Rules and prior Orders, and encouraging the Utility to engage in such behavior in the future.

The most startling feature of the audited financial statements is found in KIU's debt payment schedule, which includes a long term debt obligation of \$8,348,178, which moves from a constant \$425,000 annual payment between 2011-2013 to a one-time payment of \$7,073,176 due in 2014 (P.13 2010 Audited Financial Statement).

KIU will be required to refinance all of its debt in 2014. This brings into question the need for an interest rate swap for debt which will mature in two years, and also raises serious concerns about KIU's ability not only to refinance its existing debt, but also provide for the much needed, and fully supported, construction of the second water line which will cost at least \$5 million. If KIU is unable to finance its additional debt, it will need approximately \$8.3 million as a balloon payment in 2014, and an additional \$5 million in debt to finance the second water line, if KIU is able to secure this financing that would exceed the entire value of KIU.

The above statements are not allegations, testimony or innuendo; rather, these are hard accounting facts that are set forth in the audited financial statements of KIU which were entered into evidence, without objection by KIU or ORS. Furthermore, while we commend ORS for



acknowledging the audited financial statements, it presented no testimony regarding their content. Even though these statements were not made available until November 4, 2011, five days before ORS witnesses submitted their testimony, ORS provided no supplemental testimony once it had the chance to review the audited financial statements, just as it provided no supplemental testimony after November 16, 2011, when it first received the testimony of KPOG's expert witnesses.

There may very well be reasonable and simple explanations for the items noted above, however, it is neither the function nor the requirement of an Intervenor in a rate proceeding to review and explain these transactions. Rather, the burden of proof must continue to be shouldered by KIU to demonstrate how the public interest is served by these transactions. KIU owes the Commission an explanation of why it deliberately violated Commission rules and side-stepped Commission oversight of these transactions.

**3. The Commission failed to establish a reasonable and appropriate Operating Margin and rate increase given the current economic environment. In doing so, the Commission gave absolutely no consideration to the testimony of expert witness William Rogers. This despite the fact that neither KIU nor ORS offered any challenge to his testimony at any point during the Application.**

In the Introduction of the Order, the Commission states it must ascertain and fix just and reasonable rates...Practices to be furnished. Since the Commission issued its Order in Docket No. 2001-164-WS, KIU has passed on to its customers seven increases in the cost of water from St. John's Water Co.: two in 2004 and one each in 2006, 2007, 2008, 2009, and 2011. These pass through increases total approximately 58 cents per thousand gallons. KIU has in fact been

granted increased rates and revenues through these Commission Dockets which allow pass throughs, as well as increases in revenue generated by customer growth. In Finding of Fact No. 13 of the Order, the Commission failed to acknowledge a number of increases provided by the referenced tariff provision and conditions allowing for pass through costs of the bulk water rates of the St. John's Water Company. Therefore, it is not accurate for KIU to claim it has not received a rate increase in ten years.

The testimony of William Rogers, a well known and respected professional with extensive experience in the water and sewer utility industry, was not addressed in the Commission's Order. On page 10 of the Evidence and Conclusion for Finding of Fact No. 4 of the Order, the Commission references testimony of KPOG witnesses Blumenthal and Lanier, but not Rogers. In his expert opinion, Rogers noted among other items, KIU'S proposed operating margin was inflated and inappropriate under current economic conditions. KIU offered no testimony refuting this and raised no objection to his sworn testimony being entered into evidence; neither did ORS or KICA. The Commission's Order improperly allowed an Operating Margin far in excess of that previously authorized and, equally as important, without due consideration of any or all of the seven rate increases since 2002 authorized in Docket No. Docket 2001-164-WS nor this unchallenged expert testimony.

Rogers opined that a 7% Operating Margin would be fair to both KIU and its customers. The only reference in the Commission's Order to the critical testimony of witness William Rogers is on page 4. (emphasis supplied) Mr. Rogers was not a paid expert; rather, he is a senior executive for one of the largest water utilities in the United States with extensive experience in the utility regulation arena and well respected by his peers. In addition he has an MBA in accounting and finance from Duke University as well as a degree in engineering and economics from the United

States Military Academy. That this valuable testimony is not even mentioned in the Commission's order (other than briefly on page 4) is a significant oversight and can only lead one to believe the Commission discounted his testimony entirely<sup>1</sup>.

The Commission's Order opines that KPOG's complaints focused on the issues between KIU and its parent and use of "Return on Equity" versus "Operating Margin" for setting rates. The Commission disregards the testimony of KPOG's expert witnesses pertaining to the potential sale of KIU, a fact KIU did not disclose to the Commission, and the impact of the rate increase on the potential sale; testimony regarding the second water line and most importantly the transactions between KIU and its lender, RBC Bank. Page 15 of the Evidence and Conclusion for Finding of Fact No. 7 of the Order, the Commission improperly states the operating revenues during the test year were not directly addressed in the testimony of any of the witnesses of KPOG. Those revenues were, in fact, directly addressed by the testimony of both William Rogers and Lynn Lanier.

**4. The Commission's Order made no Finding of Fact or Conclusion of Law which addressed the public input in this proceeding. None of the comments from either the public hearing on Kiawah or letters written to the Commission were addressed in the Commission's Order. Numerous significant issues were raised by 13 public witnesses during the October 20, 2011 Night Hearing and letters from more than 100 rate payers were submitted to the Commission in opposition to the rate increase.**

In its Order, the Commission failed to address the issues raised by rate payers at the October 20, 2011 public hearing or included in letters the public submitted (KPOG Exhibit 1 to Tr. Vol.

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<sup>1</sup> KIU's witness John F. Guastella addresses William Rogers's testimony only once and summarily dismisses it (Tr. Vol. II P.482 lines 2-13).

I). The public opposition both at the hearing and in letters to the Commission is extensive and compelling. It cannot and must not be ignored.

During the night hearing held on October 20, 2011, speaker after speaker – Steven Lapp, Nick Mihalas, Richard Bennett, Lynn Morgenstern, Arthur Morgenstern, Arthur Jones, Richard Johnson, Lawrence Burpee, Ron Ritchie, P.L. Silveston, Marilyn Larach, George Zack and Dick Sula, all of whom are customers of KIU objected to the proposed rate increase. Many expressed their support for the second water line proposed by KIU. However, they opposed such a drastic rate increase as the one requested by KIU. The 39% rate increase requested translated into a 13.75% Operating Margin. The speakers went on to point out that although the Town is an affluent community, not everyone who lives there is wealthy. Many residents live on fixed incomes and have owned their homes for 20 years or more. These rate payers also expressed concern about decisions forced by KIU's parent, which benefit KRA, the parent, rather than either KIU or its rate payers.

While customers of KIU were in agreement regarding the need for a second line, concern was expressed about the cost and timing of it, as well as the injustice of the rate payers bearing the burden of paying the entire cost of the line. In his testimony on October 20, Steve Lapp acknowledged existing ratepayers should pay for that part of the cost of the line which provides service to current customers, but KIU should be responsible for the cost associated with growth and servicing new customers (Tr. Vol. I P.13 lines 10-14). Lynn Morgenstern voiced her concerns pertaining to current ratepayers paying for future ratepayers (Tr. Vol. I P.22 lines 18-23). Pete Silveston questioned the need for a new water supply during the current recession when new construction has been severely limited because of the economy (Tr. Vol. I P.42 lines 19-25, P. 43 lines 1-5).

Size and timing of the increase were also concerns for the customers of KIU, given the Commission was not informed of the potential sale of KIU to the Town of Kiawah Island. It should be noted this sale was proposed almost simultaneously with the filing of the original rate increase application in June 2011. Art Morgenstern urged the Commission to hold KIU accountable for its failure to provide any information about the impending sale when it refiled its application in August (Tr. Vol. I P.24 lines 22-25, P.25 lines 1-6). Rick Johnson requested Commissioners be fair and reasonable when making their decision with regards to the proposed rate increase request (Tr. Vol. I P.34 lines 7-17). Marilyn Larach testified the size of the proposed rate increase is unacceptable, given the current economic climate (Tr. Vol. I P.45 lines 24-25, P. 46 lines 1-3).

Any increase granted should be limited to any increases in operating costs not covered by pass through adjustments for the higher cost of water from Charleston Water System, the supplier of water to St. John's Water Company, which in turn provides water to KIU. Ron Ritchie agreed some increase should be granted, but urged the Commission consider what amount would be fair and reasonable (Tr. Vol. I P.40 lines 14-21).

Letters from KIU customers echoed these concerns about the proposed increase, as well as others. Dirck Born questioned the efficiency and effectiveness of the management of KIU. "If its operation were better controlled, would a 39% increase in water rates and a 5.4% increase in sewer rates be necessary?" (KPOG Exhibit 1 to Tr. Vol. I P.12). Nancy Johnson recognized rate increase has not occurred in 10 years with the exception of pass throughs, noting "I have had to absorb these increases even though KIU has not." (KPOG Exhibit 1 to Tr. Vol. I P.88). The customers of KIU question how much of the increase in KIU's operating costs is caused by an increase in operating costs versus the increase in costs to service a growing rate base? If the

latter is the majority, KIU is also receiving additional revenue because of a larger number of rate payers. John Mann expressed his belief that KIU wants the 39% increase for cash flow reasons because the Developer needs funding for build-out of his remaining properties (KPOG Exhibit 1 to Tr. Vol. I P.42).

Given the proposed Operating Margin is more than twice the average operating margin the Commission has approved in the five previous rate applications, customers of KIU question what responsible company would wait until it needed a 39% increase in rates before seeking relief. Emelie Born's letter expressed concern that KIU is seeking a profit margin of almost 14% and it appears to be almost double the average of past increases granted by the PSC (KPOG Exhibit 1 to Tr. Vol. I P.44).

Since Kiawah Island Utility does not operate independently from its owner, but is a wholly owned subsidiary of Kiawah's master developer, Kiawah Resort Associates, letters from KIU's customers urged the Commission to provide even greater scrutiny to the requested rate increase in order to protect rate payers' interests. Ann & Lawrence Burpee compared KRA's practices to other developers' practices. (KPOG Exhibit 1 to Tr. Vol. I P.55). Ray Khayali questioned whether KIU made its decisions based on what is best for its rate payers or what is best for its parent company (KPOG Exhibit 1 to Tr. Vol. I P.33). Wendy Kulick noted arms-length transactions between KIU and KRA are nonexistent and in contrast to virtually every other privately-owned utility in South Carolina (KPOG Exhibit 1 to Tr. Vol. I P.51). Former Mayor James V. Piet stated his major concern is the burden the requested rate increase places on rate payers to pay for needed infrastructure additions and repairs (KPOG Exhibit 1 to Tr. Vol. I P.54). As a previous Property Owner Director on the KICA Board of Directors, Laura Pulleyn was very familiar with conflicts between the residents and KRA regarding efficiency and cost

effectiveness (KPOG Exhibit 1 to Tr. Vol. I P.43). In response to a question from Commissioner Fleming, Rich Bennett testified that previous Commissions have allowed costs typically paid by developers everywhere else to flow into the rate-base calculation (Tr. Vol. I P.21 lines 6-10). He also commented on a third-party buyer of KIU eliminating the immense conflicts of interest created by the Developer owning the Utility, rather than an independent operator (Tr. Vol. I P.19 lines 12-18).

The Commission should not render its decisions based upon the ability of customers to pay a few dollars more each month. The decisions should be based upon those costs and expenses the utility can actually justify. Robert Clement stated in his letter that the increase should not be is not about the customers' ability to pay, but rather about what increase KIU can justify (KPOG Exhibit 1 to Tr. Vol. I P.15). Diane Lehder also stated it is about fairness and KIU should receive only what it can justify (KPOG Exhibit 1 to Tr. Vol. I P.70).

ORS is charged with representing the public interest in utility cases which come before the Commission. Further, the enabling act creating the ORS defined public interest as a balance among three essential components: the concerns of the using and consuming public; the financial integrity of public utilities; and the economic development of South Carolina. KPOG would be remiss if it did not bring to the Commission's attention, that it is ORS's mission to address the first two of its essential responsibilities in this proceeding.

During the hearing held on November 30, 2011, ORS witness Hannah Majewski testified ORS usually recommends between 10-15% Operating Margin (Tr. Vol. II P. 456 lines 7-8). She gave no rationale for this range, simply that it is the one ORS uses. To a utility consumer, one can interpret this to mean a company request of an Operating Margin within the range of 10-15%, ORS will allow the requested increase, even if it is unwarranted simply because it falls

within the acceptable range. Additionally, the Commission waived oral arguments and directed final arguments in the form of proposed Orders (Tr. Vol II P. 500 lines 5-14). In response, **nearly identical** drafts were submitted to the Commission by KIU and ORS. It is incumbent upon the Commission to ensure that the public interest is at the forefront. It is ultimately up to the Commission to do so.

**5. KPOG respectfully disagree with the Commission's February 1, 2012 Directive denying KPOG'S request to overrule the Hearing Officer's Denial of its Motion to Compel and KPOG's request to take judicial notice of certain Charleston County property tax records.**

KPOG included its Second Set of Interrogatories to KIU as Stipulated Exhibit No.26 at the November 30, 2011 Hearing. KIU objected to the Second Set of Interrogatories on the grounds of relevance alone (Tr. Vol. II P. 79 lines 21-22 and P. 80 line 5). At no time during the hearing did KIU raise an objection to the timing of the Interrogatories' filing. While Reg. 103-833(B) requires that Interrogatories shall not be served less than 10 days before the hearing unless good cause is shown, Reg. 103-833 (B) states that the person upon whom the interrogatories have been served shall serve a copy of the answers and objections within the time period designated by the party of record submitting the interrogatories, but not less than 20 days after the service thereof, unless the time is extended by the Commission for good cause shown. KIU did not voice its objection to KPOG's Second Set of Interrogatories until January 10, 2012, which was approximately 57 days after it received KPOG's Second Set of Interrogatories<sup>2</sup>. In fact, KIU submitted additional rebuttal testimony of three witnesses on November 23, 2011, the same day as the Interrogatories were filed. The only way to resolve KIU's objections was through a

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<sup>2</sup> Also note that these Interrogatories were made exhibits at the November 30, 2011 hearing. (Stipulated Exhibit 26)



Motion to Compel. Therefore the Commissions' regulations 103-833 (B) contemplate the possibility of a motion and perhaps even an additional hearing to resolve the matter.

Additionally, nothing in the hearing transcript states the record was to be closed after the November 30, 2011 hearing. In fact the record remained open **pending final argument**, through proposed orders from all parties due on January 18, 2012. Further, even if the Commission had deemed the record closed, there are no regulations which preclude or prevent the Commission from reopening or requesting an additional hearing when necessary to receive information such as Charleston County tax records to assist it in rendering its decision.

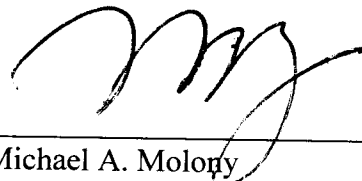
KIU argues that the South Carolina Rules of Evidence do not apply. However; the Commission has the authority to take judicial notice of adjudicative facts if they are "capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned," Rule 201, SCRE. The subject records are public documents, authenticated by the public officer responsible for them and accessible by the public online. Judicial notice can be taken at any time by this tribunal, thus, this request **is** timely, Rule 201(f), SCRE. In the Evidence and Conclusion for Finding of Fact 1 of the Order, the Commission properly takes judicial notice of its prior orders and dockets filed with the Commission, but improperly states that no issues in the prior orders were contested by any party.

### **Relief Requested**

The Commission has extensive powers to govern the rates and practices of utilities operating in the State of South Carolina. The Commission's governing statutes (e.g. § 58-7-20, et seq.) and Commission Rules have a singular purpose: to protect the interest of the public. To do so, KPOG respectfully requests the following from the Commission:

1. The Commission should disallow all of the expenses related to the 2008 and 2009 deed transfers and all of the related RBC loan transaction expenses and direct KIU to remove all the expenses related to these transactions from the approved rates;
2. The Commission should require KIU to provide a Statement of Compliance with Commission Regulations 103-541- and 103-743 to include related party transactions, interest rate swap liability and, most importantly, that the debt repayment schedule as set forth in the audited financial statements will not impair the continued operations of KIU upon maturity of all outstanding debt in 2014.
3. The Commission should establish an appropriate and reasonable operating margin in the current economic environment. In doing so, the Commission should carefully evaluate and recognize the unchallenged expert witness testimony of William Rogers and the extensive testimony and letters of opposition from members of the public.
4. The Commission should require KIU to provide the documents requested by KPOG in the Second Set of Interrogatories and to take judicial notice of the public record of the Charleston county property tax records.
5. The Commission should set the issues herein for oral argument and direct such other and further relief as it deems appropriate to protect and advance the public interest of the rate payers on Kiawah Island.

RESPECTFULLY SUBMITTED,



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